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News & Events

Tax Relief, Unemployment Insurance Reauthorization & Job Creation Act of 2010

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The 2010 Tax Act, formally named the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Act"), was signed into law by the President on December 17, 2010. Among other things, the Act changes the Federal estate, gift, and generation-skipping transfer ("GST") tax laws. Most of the Act's provisions are taxpayer friendly, however the provisions sunset at the end of 2012 so that the new provisions are currently only in effect for years 2011 and 2012. Below is an overview of the Federal estate, gift, and generation-skipping transfer tax provisions and how these provisions may affect your present and future estate plans.

Estate Tax

Under prior law, the Federal estate tax was gradually reduced over several years and then eliminated for decedents dying in 2010. Under prior law the Federal estate tax, with a maximum tax rate of 55 percent and a $1 million applicable exclusion amount (the "exemption amount"), would be reinstated after 2010. The exemption amount is the maximum amount of assets that an individual can pass at death free of Federal estate tax.

The Act reinstates the estate tax for decedents dying during 2010 with an exemption amount of $5 million and a tax rate of 35 percent. The Act's provisions continue for decedents dying in 2011 and 2012. Unfortunately, this new regime is temporary and will sunset on December 31, 2012 unless Congress acts to extend it. When it expires, the prior estate tax laws, described above, will be reinstated.

The Act also reinstates the stepped-up basis rules applicable under prior law. The effect of this is that most beneficiaries take an income tax basis in the inherited property equal to the asset's date of death fair market value rather than the basis in the hands of the decedent. This was the rule prior to 2010.

The Act also provides for "portability" between spouses of the unused exemption amount for estates of decedents dying in 2011 and 2012. Portability allows a surviving spouse to elect to take advantage of the unused portion of the estate tax exemption amount (but not any unused GST tax exemption) of their predeceased spouse, thereby providing surviving spouses with a larger exemption amount than they would have on their own. As a simplified rule, this allows spouses with taxable estates of $10 million or less to avoid Federal estate tax and lessens the importance of balancing asset ownership between spouses during life. Special limits apply to decedents with multiple predeceased spouses. However, the benefit of portability is somewhat illusory because, as the law currently stands, both spouses must die before 2013 to take advantage of this provision.

Gift Taxes

For gifts made in 2010, the maximum gift tax rate was 35 percent and the applicable exclusion amount was $1 million. For many years prior to 2010, the gift tax rate was 45 percent. For gifts made in 2011 and 2012, the Act limits the maximum gift tax rate to 35 percent. The estate tax exemption and gift tax exemption are now “unified” at $5 million. Donors continue to be able to use the annual gift tax exclusion before having to use any part of their lifetime gift tax exemption. For 2010 and 2011, the annual gift tax exclusion amount is $13,000 per donee (married couples may continue to "split" their gift and may make combined gifts of $26,000 to each donee). As was the case before the Act, lifetime gifts in excess of the annual gift tax exclusion reduce the amount passing estate tax free upon death.

Generation Skipping Transfer ("GST") Tax

The Act provides a $5 million GST exemption amount for 2010 through 2012, increased from an exemption amount in 2009 of $3.5 million. For transfers made after 2010, the GST tax rate is 35 percent, which is a reduction from the 2009 rate of 45 percent. The Act also extends certain technical provisions under prior law affecting the GST tax.

Below is a chart summarizing exemption amounts and rates:

Exemptions and Rates	2011	2012	2013
Estate tax exemption	$5 million	$5 million	$1 million
Gift tax exemption	$5 million	$5 million	$1 million
GST tax exemption	$5 million	$5 million	$1 million
Gift and estate tax rate	35%	35%	55%
GST tax rate	35%	35%	55%

Please review the frequently asked questions on the following page and contact us if you would like to discuss your current estate plan in light of the Act.

Frequently Asked Questions

(Q) If my estate is less than $10 million, will I avoid estate taxes completely?

(A) No, unless you die by the end of 2012, there is no guarantee that the $5 million exemption amount and portability of the unused exemption amount between spouses will continue to be available. Further, Minnesota still imposes estate taxes on estates that exceed $1 million.

(Q) How much will Minnesota estate taxes cost?

(A) This depends on the provisions of each estate plan and the size of the taxable estate. Unlike the Federal law, portability of the unused estate tax exemption is not allowed under Minnesota law with respect to Minnesota estate taxes. For example, clients with a combined estate of $10 million may avoid federal estate tax completely but would trigger approximately $1 million of Minnesota estate taxes in 2013. For most clients, basic estate planning will save approximately $100,000 in avoidable Minnesota estate taxes.

(Q) Is now a good time to consider making large lifetime gifts?

(A) Possibly. The increased gift tax exemption and reduced gift tax rate provide significant short-term gifting opportunities under the right circumstances. Unfortunately, we do not know whether the favorable changes to the gift tax laws will be extended beyond 2012. For individuals that felt constrained by the previous $1 million lifetime gift tax exemption, now may be an opportune time to take advantage of the favorable tax law changes. Strategies exist that can further leverage the $5 million exemption amount and remove appreciating assets from an individual’s taxable estate without losing the economic benefit of the assets during the individual’s lifetime.

(Q) What if I have not updated my estate plan documents in the past five years?

(A) The increased exemption amount under the Act has the potential to cause assets to be distributed in ways not contemplated when the estate plans were put in place. This is generally the result of a “funding formula” used to fund a credit shelter trust (also known as a “family trust” or “Trust B”) established in a will or revocable trust when the exemption amount was $1 million or less. For example, in 2003, a will may have funded a credit shelter trust with $1 million, with the remainder passing to the surviving spouse. That same will in 2011 could fund the credit shelter trust with $5 million, greatly reducing the amount passing to the surviving spouse. This may or may not be a desired result. Therefore, it is important to review the terms of your existing estate plan every five years and especially in light of the Act.